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SUBJECT: INDONESIA TRADE AND INVESTMENT HIGHLIGHTS - FEBRUARY 2007

11. Summary: Minister of Trade Mari Pangestu said on February 26 that a global economic slowdown could reduce Indonesia's export growth to 14.5% in 2007, lower than the Government of Indonesia's (GOI) 20% target. The GOI issued a regulation on January 2 granting tax incentives for Indonesian companies or cooperative investments in certain business sectors. According to industry data, domestic motorcycle sales rose 28.5% in January 2007 on a year on year (YoY) basis, while automobile sales grew only 0.62% in January 2007 and dropped 8% in February 2007 YoY. The Investment Coordinating Board (BKPM) announced on February 7 that realized foreign direct investments (FDI) in Indonesia's automotive sector reached \$438.5 million in 2006. Riken Corporation of Japan and PT. Pakarti Riken Indonesia announced they would begin manufacturing vehicle engine camshafts in Indonesia to supply the Southeast Asia region beginning this summer. The Ministry of Trade (MOT) announced on February 26 that it would not allow a Japanese 7-Eleven retailer to expand its operations to Indonesia without a local partner. The MOT also announced on February 14 that it has authorized BULOG to import 500,000 tons of rice from March to April 2007. Indonesia's Toll Road Regulatory Body (BPJT) announced on February 16 that it will tender six toll road projects in the Jakarta area. High world commodity prices drove Indonesia's exports in 2006 to a record \$100.7 billion. End summary.

GOI Sets 2007 Export Growth Target of 20%

12. Vice President Jusuf Kalla chaired a cabinet level coordination meeting on trade on February 26 to discuss ways to meet President Yudhoyono's goal of 20% export growth in 2007. After the meeting, Kalla told the press Indonesia's improving infrastructure and financial sector strength will enable the country to meet this target. He asked that the country's banking sector increase lending and other support to the export manufacturing sector. However, according to press reports, Trade Minister Mari Pangestu said that 14.5% export growth was a more reasonable target for 2007. She noted that the world economy may be slowing and that existing stockpiles of commodities could drive down record high commodity prices, as well as the value of Indonesia's total exports in 2007. Indonesia recorded export growth of 19.7% percent in 2006 with total exports topping \$100 billion (\$100.7 billion) for the first time.

GOI Implements New Investment Incentives

13. On January 2, the GOI issued a regulation (PP1) granting tax incentives for Indonesian domestic investments in certain business sectors effective January 1, 2007. The new regulation provides:

-- Accelerated depreciation of fixed assets at twice the rate under normal circumstances;

-- Tax loss carry-forward up to 10 years (instead of 5);

-- Investment tax credit reduction of net income by 30% of capital (land, buildings, equipment) invested to be pro-rated over six years, at 5% per year.

Only investments in Indonesian companies (domestic "PT" or limited liability companies) or Indonesian cooperatives ("Koperasi") qualify for the incentives. Qualifying investments must also be made in the following sectors:

- Food seasoning;
- Textiles and garments;
- Pulp and Paper;
- Carton and Cardboard;
- Industrial or chemical substances;
- Rubber or rubber products;
- Porcelain;
- Base metals, base iron and steel;
- Machinery and accessories;
- Electric motors, generators, transformers;
- Electronics;
- Land transportation;
- Ship building and repair.

¶4. Some investment analysts have raised concerns about the scope of the regulation, noting that the GOI should expand it to encourage more high-tech and capital intensive investments. They added that, without significant GOI progress in implementing other promised investment related reforms, it is unlikely that the new regulation

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will have a significant impact on new investment, particularly from overseas.

Motorcycle Sector Rebound; Autos Remain Sluggish

¶5. The Indonesian Motorcycle Industry Association (AISI) announced on February 19 that domestic motorcycle sales rose to 342,773 units in January 2007, a 28.5% increase YoY from 266,618 units. AISI also reported that Astra International -- the largest motorcycle dealer in Indonesia -- increased its market share slightly to 45% in January 2007 from 44% a year earlier. Honda and Yamaha products dominate Indonesia's domestic motorcycle market. Honda sales rose 31.4% YoY to 153,806 units in January, while Yamaha recorded a 25.4% increase YoY to 133,200 units.

¶6. Indonesia Automotive Industries Association (Gaikindo) announced on February 19 that domestic car sales reached 26,788 units in January 2007, a slight increase of 0.62% YoY from 26,622 units in ¶2006. Car sales, however, subsequently fell 8 percent in February 2007 to 23,811 from 25,959 units in February 2006. Gaikindo reported that Astra International -- Indonesia's largest car dealer -- suffered a drop in market share to 56% in January 2007 from 65% in January 2006. Astra's car sales fell to 15,016 units in January, from 17,351 a year earlier, and from 16,390 in December 2006. Astra Investor Relations Head Richard Santosa said on February 19 that the company no longer enjoyed the backlog of orders that boosted sales for most of 2006. Indonesia's vehicle sales plunged by roughly 40% in late 2005 and early 2006 following an October 2005 GOI decision to dramatically reduce fuel subsidies. Subsequent higher fuel prices have caused consumers to shift to smaller more fuel-efficient models. Vehicle sales reached a record high of 533,910 units sold in 2005, but plunged to just 318,883 units sold in 2006, a decline of 40%. Industry analysts predict vehicle sales will reach between 350,000 and 400,000 units in 2007.

Table 1: Domestic car sales

Brand/company	Jan 07	Feb 07	Jan 06	Feb 06
Honda	2,313	3,350	3,598	2,384

Suzuki	3,837	3,504	2,330	2,768
Toyota	9,530	8,057	13,191	9,609
Astra International	15,016	12,490	17,351	15,872
Daihatsu	4,097	2,997	2,842	2,728
Mitsubishi	3,658	2,305	1,979	3,314

Total	26,788	23,811	26,622	25,959

Source: Gaikindo

¶7. The Investment Coordinating Board (BKPM) announced on February 7 that actual realized foreign direct investment (FDI) in the automotive sector reached \$438.5 million in 2006, the highest amount in the last six years. The BKPM reported that foreign investors implemented 28 projects in the automotive sector in 2006, compared to 31 projects in 2005. The \$438.5 million figure represents a 22% from the \$359.7 million invested in 2005. According to BKPM, the automotive sector accounted for 7.3% of total FDI projects in 2006.

Japan Investor to Produce Automobile Parts

¶8. Japan's Riken Corporation and its domestic partner PT. Pakarti Riken announced on February 23 that they will begin production of camshafts for automobile engines in Indonesia by the summer of 2007.

Riken says that the move is part of the company's broader efforts to cut delivery times and integrate production operations in Southeast Asia. Riken will hold a 40% stake in the endeavor and will invest \$2.5 to \$3.3 million in facilities that can manufacture 50,000 automobile camshafts per month. Riken said it chose Indonesia as a production base because large automakers, such as Toyota and Daihatsu, are increasing production in the country.

MOT Requires 7-Eleven Retailer to Use Local Partner

¶9. Minister of Trade Mari Pangestu announced on February 26 that her ministry would not approve plans of a Japanese 7-Eleven retailer to expand into Indonesia's retail sector. With support from the Government of Japan, the retailer proposed to invest in a retail

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chain that it would fully own and control. According to Pangestu, the GOI would not alter existing Indonesian retail regulations, regardless of the outcome of Economic Partnership Agreement (EPA) negotiations between the two countries. Minister of Trade Decree on Franchising No.12/2006 requires that international franchises use local partners when expanding operations to Indonesia. In recent years, mini-market franchises have spread across Indonesia, particularly in urban areas. Growth of these modern markets has increased government revenue and formal sector employment. However, the country's traditional traders often complain that they cannot compete with the lower prices of mini-markets and larger hypermarkets. Traditional traders and some politicians in the past have called on the GOI to place greater controls on the development of modern markets in Indonesia.

MOT Authorizes BULOG to Import Rice

¶10. Following a rice coordination meeting on February 13, the MOT announced on February 14 that it has authorized the National Logistic Agency (BULOG) to import 500,000 tons of rice. On February 21, BULOG indicated that it would import 200,000 tons of rice through government to government mechanisms, 200,000 tons through direct appointment to certain rice importers, while the remaining 100,000 tons would be sourced through an open tender process. Ministry of Trade authorization letter no. 138/2007 authorizes BULOG to import the following amounts of rice through 14 ports between March and April this year:

-- Lhokseumawe, Aceh	6,000 tons
-- Belawan, North Sumatra	24,000 tons
-- Teluk Bayur, West Sumatra	12,000 tons

-- Dumai, Riau	22,000 tons
-- Panjang, Lampung	36,000 tons
-- Tanjung Priok, Jakarta	40,000 tons
-- Tanjung Emas, Central Java	60,000 tons
-- Tanjung Perak, East Java	180,000 tons
-- Ujung Pandang, South Sulawesi	24,000 tons
-- Pare-pare, South Sulawesi	42,000 tons
-- Celukan Bawang, Bali	6,000 tons
-- Mataram, West Nusa Tenggara	12,000 tons
-- Kupang, East Nusa Tenggara	30,000 tons
-- Jayapura, Papua	6,000 tons

¶11. Rice is a staple food for most Indonesians and constitutes a significant component of poverty calculations in the country. From January 1 - March 2, 2007, rice prices increased 17.7% to \$0.67 per kg. An October 2006 World Bank Study indicated that rice price increases were largely responsible for an increase in Indonesia's poverty rate in 2006 to 17.8% from 16% in 2005.

Jakarta Toll Road Tenders Move Forward

¶12. Indonesia's Toll Road Regulatory Body (BPJT) announced on February 16 that it would tender six toll road projects in the Jakarta area worth an estimated \$2.55 billion. The BPJT said that the projects are part of a Jakarta provincial government initiative to build new highways to reduce traffic congestion in the city. Bid selections will reportedly begin in June and July 2007. The six projects include:

- A 9.65 km road connecting Kemayoran in Central Jakarta and Kampung Melayu in East Jakarta;
- A 11.38 km road connecting Tomang in West Jakarta and Kampung Melayu in East Jakarta;
- A 18.95 km road connecting Rawa Buaya in West Jakarta and Sunter in North Jakarta;
- A 14.73 km road connecting Sunter in North Jakarta and Pulo Gebang in East Jakarta;
- A 9.56 km connecting Pasar Minggu in South Jakarta and Casablanca in Central Jakarta; and
- A 8.27 km connecting Ulujami in South Jakarta and Tanah Abang in Central Jakarta

Information on the tender can be found on the Indonesian Ministry

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of Public Work website at <https://eproc.pu.go.id>.

Indonesia Rides the Commodities Boom

¶13. Indonesia's exports soared for the first time to over \$100 billion in 2006, underpinning respectable gross domestic product growth of 5.55 for the year. A rise in non oil and gas exports, particularly commodities, drove the country's strong export performance. In general, high prices, rather than increases in export volumes, led to the large increases in many commodities (Table 3). Among commodities, close analysis of Indonesia's trade data, however, indicates that 2006's non-oil export boom largely resulted from high world commodity prices rather than significant increases in export volumes. Exports of Indonesia's top manufactured goods have remained flat or declined. Most analysts believe that Indonesia can likely depend on continuing strength in global commodity prices to support solid export-led GDP growth. In the longer term, though, limited investment in manufacturing facilities and growing infrastructure bottlenecks may hinder export growth, especially if commodity prices flatten out.

Table 2: Indonesia Trade Performance 2006
(in \$ billions)

	2005	2006	% YoY(1)
Exports	85.6	100.7	17.5
Oil and Gas	19.2	21.2	10.2
Non-oil and Gas	66.4	79.5	19.7
Imports	57.7	61.0	5.8
Oil and Gas	17.5	18.9	8.7
Non-oil and Gas	40.2	42.1	4.6
Balance of Trade	27.9	39.7	42.3

(1) Percent increase year-on-year.

Table 3: Indonesia's Top Non-Oil and Gas Exports
2006 (in \$ billions)

Commodity	2005	2006	Pct of Total 2006
Electrical tools	7.33	7.30	9.18
Coal	4.48	6.47	8.14
Crude Palm Oil	4.95	6.00	7.56
Rubber and rubber products	3.58	5.54	6.97
Ash and Residues	3.49	4.90	6.17
Machinery/mechanical tools	4.56	4.39	5.52
Garments - not Knitted	3.07	3.38	4.25
Wood and wood products	3.11	3.33	4.19
Copper	1.26	1.90	2.40
Chemical Organic	1.53	1.83	2.30
Total top 10 products	37.38	45.06	56.67
Other	29.05	34.45	43.33
Total non-oil and gas exp	66.43	79.50	100.00

Table 4: Indonesia's Main Non-Oil and Gas
Export Destinations
2006 (FOB value, in \$ billions)

Country of Destination	2005	2006	Percent of Total (2006)
Japan	9.56	12.20	15.35
European Union	10.23	11.96	15.04
U.S.A.	9.51	10.66	13.41
Singapore	7.07	7.81	9.82
China	3.96	5.45	6.86
Malaysia	3.31	3.73	4.69
South Korea	2.59	3.40	4.28
Taiwan	1.78	2.27	2.86
Australia	1.13	1.62	2.04
Others	17.27	20.39	25.66

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Total 66.43 79.50 100.00

Source: Central Bureau of Statistics (BPS)

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